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ADVANCE LETTER ON GENERAL BUSINESS CONDITIONS

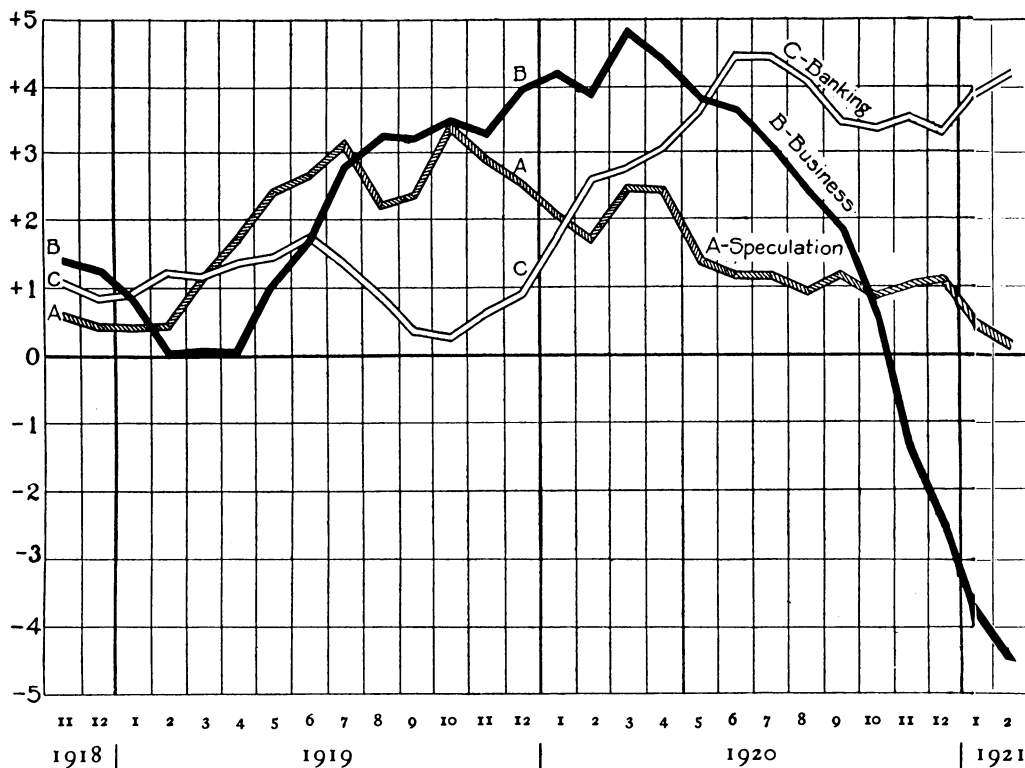
March 16, 1921

(THE DATE REFERS TO THE DAY OF FINAL REVISION)

THE INDEX

AT the present time curve C, rates on commercial paper, is the most significant of the three curves of our Index Chart. In January and February this curve, in which allowance is made for seasonal variation, moved upward. That is to say, although money

During pre-war periods of liquidation the normal interval between the culmination of money rates, curve A, and the end of the period of liquidation in business as shown by curve B was 9-11 months. Counting 9-11 months from June 1920 gave us March-May 1921 as the date of the termination of the downward movement of



INDEX CHART. The items locating curves A, B, and C all refer to complete calendar months and the points are plotted in the middle of the spaces allotted to the months.

GROUP A — SPECULATION: New York Bank Clearings, Shares Traded on the New York Stock Exchange, Price of Industrial Stocks.
GROUP B — BUSINESS: Bank Clearings Outside New York City, Bradstreet's Price Indices.
GROUP C — BANKING: Rate on 4-6 Months Commercial Paper, Rate on 60-90 Day Commercial Paper.

EXPLANATION: Each of the three curves on the Index Chart is obtained by averaging a group of statistical series, each group being composed of series homogeneous in character; i.e., when corrected for the seasonal influence and normal growth, the series of each group move in the same direction (upward or downward) at the same time. The series were all expressed in comparable units before averages were taken.

Our interpretation of the fluctuations of the three curves of the current index chart is based upon the relationship which was discovered among similar curves for the period 1903-14. All three curves had wave movements, but the upward swings and the crests of the waves were not reached simultaneously. The major movements of speculation preceded those of business by 4 to 10 months, and the movements of business preceded those of banking by 2 to 8 months. The sequence of movements holding for upward swings and crests also held for downward swings and troughs.

The persistent decline of curve A and the equally persistent rise of curve

rates have become somewhat easier since the first of the year, they have not declined as much as they should normally at this season. A revival of business is usually preceded by a sharp decline in money rates which is presently, and sometimes immediately, followed by an increase of speculative activity. In the first quarter of 1921 this signal of a revival in business has been lacking, and we conclude, therefore, that liquidation has not yet run its course, and that a general revival of business activity will not come about as early as we have expected.

C, both movements beginning in November 1919, indicated that a decline of business activity and commodity prices, curve B, would be inaugurated in the spring of 1920. In fact business unsettlement was noticeable in April and it has increased since that month while various indices of commodity prices have receded since May. The existence of the federal reserve system and the action of the banks in increasing rates and restricting credit made it appear very unlikely that the business readjustment indicated by the index chart would be accompanied by a financial panic. At this writing, we have passed the time in the business cycle when a financial panic would have occurred, if we were to have one.

Finally, the rise of curve C in January and February 1921 indicates that the period of readjustment of business will be prolonged at least until the summer of 1921. The prospect is a slowing down in the decline of wholesale commodity prices, a somewhat easier money market, and moderately higher security prices.

business. It now appears that the present period of readjustment will be longer than the usual pre-war interval, partly because the federal reserve system has moderated the process of liquidation and partly because of the factors that are discussed in the following paragraphs.

The importance which we attach to the movement of our money curve does not mean, of course, that the mere difference between 7 or 8 per cent interest and 6 per cent is the only, or even the principal, factor in the present business situation. It is not the difference of one or

more per cent, but the conditions that bring about that difference, which produce at present a situation unfavorable to speculative and business activity.

It is possible, but not probable, that rates on commercial paper will drop below 6 per cent in the next three months. A rapid easing of the money market is improbable for the following reasons:

(1) Banks are in debt to the federal reserve system. The liquidation of their debts will result in a stronger position of the reserve and member banks rather than greatly reduced rates to investors or business men.

(2) The foreign demand for capital is insistent. New issues appear currently in the market regardless of high rates.

(3) The domestic demand for capital also appears to be large. An element in the present situation is the large demand for funding the floating debts of domestic corporations; successful funding will, of course, relieve the short-time market, but until long-time securities are digested short-time rates are apt to be high. The railroads and public utilities are also in need of capital and may be expected to make large demands on the market as interest rates recede and business improves.

(4) Continued unsettlement in Europe and the fact that changes in the tariff and federal tax laws are impending in the United States, make capital cautious and incline most people to pursue a waiting policy.

The statements just made do not mean that we expect actual rates to move upward. On the contrary, our reading of the Index Chart and our analysis of the financial situation both lead us to expect somewhat lower money rates presently. The facts, that speculation (curve A) is at low ebb, that wholesale prices have declined over 40 per cent, that outside clearings have decreased about 25 per cent during the past year (curve B), and that the strain on the money market has grown less in the last 3 or 4 months as shown by steady progress in the liquidation of debts of member banks to their reserve banks and the improved federal reserve position, indicate that somewhat easier money is in prospect.

Although the definite end of commodity liquidation is not immediately at hand, improvement of business in many of the industries that have been pretty fully liquidated is in evidence. The change that has taken place since the first of the year is unmistakable. Readjustment in numerous lines is nearly, if not quite, complete. What remains is to complete liquidation in other lines and reestablish normal relationships between all prices, including the price of labor. It is now evident that liquidation will require a longer time than obtained in similar phases of the business cycle between 1903 and 1914, but in other respects it seems to be running a normal course and we are justified in feeling confident about the outcome.

BUSINESS

Bradstreet's index number for March 1 was \$11.86, a decrease of 4.1 per cent from the index for February 1.

Two of the groups of which it is composed — live stock and breadstuffs — advanced, three — fruits, coal and coke, miscellaneous — were unchanged, and eight declined. Some of the latter, such as hides, textiles, and metals, have been conspicuous sufferers earlier in the present period of liquidation, while others, such as oils, and naval stores, have been less affected. The peculiar method of calculating this index number gives especial weight, however, to the fall of 5 per cent in the price of textiles.

Bank clearings outside New York City were 1,211 millions in February, compared with 1,496 millions in January, a decrease of 19 per cent. In pre-war years February clearings were usually about 16 per cent below the January figures.

A recent investigation made by the Harvard Bureau of Business Research reveals some interesting conditions in the wholesale grocery trade, which probably are roughly representative of the wholesale trade in general. As compared with a year ago there was a decrease of some 30 per cent in net sales, and a considerable falling-off in accounts and notes payable and receivable. The cost of doing business was not reduced in anything like the same proportion, however, with the result that profits were either wiped out or greatly reduced. It is the opinion of the Bureau that in this line "the readjustment is by no means complete."

SPECULATION

The volume of sales on the New York Stock Exchange showed no tendency to increase during the first third of the month, but during the last few days trading has been more active. Transactions were above a million shares on March 11, for the first time since January 11. This development was evidently the result of a wave of bearish sentiment induced by the complications of the European situation, for the prices of stocks, both rails and industrials, were adversely affected. Bond prices declined a fraction of a point, but this is attributable to the financial difficulties of the railroads and the condition of the money market. The slowing-down of new financing, which has characterized the investment field for the past month, will doubtless continue until more progress has been made in absorbing recent issues, or until easier money rates develop from other causes.

BANKING

The reserve ratio of the federal reserve banks has steadily, although slowly, increased since the first part of the year, while interdistrict borrowings and loans to member banks have declined. Rediscount rates, however, have not been reduced. The prevailing rate on 4-6 months commercial paper (which indicates the condition of the short-time money market) is still $7\frac{3}{4}$ per cent, a decline of only $\frac{1}{4}$ per cent since the opening of the year.